No. C540

IN THE

# United States
# Circuit Court of Appeals,

## FOR THE NINTH CIRCUIT.

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In the Matter of
Routt Lumber Company,
a corporation,
Bankrupt.

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Standard Planing Mill, a corporation,
*Appellant,*

*vs.*

Pacific Coast Paper Company, Pacific Portland Cement Company, Sloss & Brittain, and A. Holm, assignee of Redwood Manufacturers Company, Wendling-Nathan Company and Sugar Pine Lumber Company, Ltd.,
*Appellees.*

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## APPELLANT'S BRIEF.

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## APPELLANT'S BRIEF.

### Statement of Case.

This is an appeal by the Standard Planing Mill, a corporation, from an order made and entered on the 29th day of June, 1931, by the District Court of the United States for the Southern District of California, Northern Division, Hon. George Cosgrave, District Judge thereof, extending the receivership of the alleged bankrupt Routt

Lumber Company, over to and including the properties and assets of the Standard Planing Mill, appellant herein.

The major question in controversy being submitted on this appeal is whether the Routt Lumber Company and the appellant Standard Planing Mill are one and the same, *alter ego* each of the other. In order not to confuse the issue, we shall direct this brief almost entirely to a consideration of this question.

## Statement of Facts.

On April 8th, 1931, an involuntary petition in bankruptcy was filed in the office of the clerk of the District Court of the United States for the Southern District of California, Northern Division, against the Routt Lumber Company, a corporation.

On April 15th, 1931, a petition was filed for the appointment of a receiver in bankruptcy for said Routt Lumber Company and thereafter said petition was granted and C. W. Krumbholz of the city of Fresno was appointed receiver of said alleged bankrupt corporation.

Thereafter the alleged bankrupt corporation, to-wit, Routt Lumber Company, duly filed its answer to the said involuntary petition in bankruptcy, denying the allegations thereof and demanding a jury trial. The issues thus raised have not yet been determined and no adjudication in bankruptcy of said Routt Lumber Company has as yet been made.

On April 14th, 1931, the petitioning creditors of the alleged bankrupt Routt Lumber Company filed a petition in the District Court of the United States for the South-

ern District of California, Northern Division, for an injunction praying for the staying and enjoining of the prosecution of an action theretofore filed in the Superior Court of the state of California in and for the county of Fresno, in which L. W. Ellis was plaintiff and Standard Planing Mill was defendant; and also for the staying and enjoining of the execution sale under the judgment procured by the said L. W. Ellis in said action against the said Standard Planing Mill. The petition for said injunction set forth, amongst other things not pertinent to the issue now before the court, that the Routt Lumber Company, the alleged bankrupt, and the Standard Planing Mill are "one and the same *alter ego* and business conduit" each of the other and that therefore should the plaintiff in said Superior Court action, L. W. Ellis, receive payment of his claim under the execution, he would thereby obtain an advantage which would be unjust and inequitable to the other creditors of the said alleged bankrupt Routt Lumber Company. A temporary restraining order was thereupon granted by the said District Court and thereafter, to-wit, on April 28th, 1931, upon a full hearing and determination of the matters set forth in said petition, the Honorable Paul McCormick, sitting in said District Court at its regular session in the city of Fresno, dissolved said aforesaid temporary restraining order and refused to issue the injunction prayed for.

Thereafter and on the 6th day of June, 1931, the said petitioning creditors of the alleged bankrupt Routt Lumber Company filed a petition in the District Court of the United States for the Southern District of California,

Northern Division, to extend the receivership of said alleged bankrupt Routt Lumber Company to include the properties and assets of the appellant Standard Planing Mill. (This petition is set forth in the transcript, commencing at page 35.) The petition was heard by the court entirely upon the affidavits, which are fully set forth in the transcript, and no oral testimony of any kind from any witness was taken.

On June 29th, 1931, the court made a minute order granting said petition (this order is to be found in the transcript, commencing at the bottom of page 67), and from such order this appeal is taken.

## Argument.

We are fortunate in that the entire evidence is contained in the affidavits set forth in the transcript, no oral testimony of any kind having been taken, because it enables this court to have the entire record before it. It is obvious that the affidavits in support of the petition were made by people who, at the time of making such affidavits, were new to the situation and unfamiliar with the facts. These affidavits are clearly based on hearsay and the opinion of said affiants. We can well imagine the plight of these witnesses had they been on the witness stand and subjected to cross-examination. On the other hand, the affidavits in opposition to the petition were made by people who are entirely familiar with the facts of their own knowledge, being either officers or employees or stockholders of appellant.

## POINT I.

### The Burden of Proof Was on Appellees, Who Have Failed by a Preponderance of the Evidence to Establish the Allegations of the Petition.

Obviously, no authority is necessary for the contention that the burden of proof was upon the appellees. The record unquestionably discloses that they failed in that responsibility.

The affidavits in opposition to the petition made by officers, employees and stockholders, respectively, of appellant corporation, all of whom were familiar with the records, business and affairs of appellant, of their own knowledge, show:

(a) That, aside from Leonard W. Routt and Virgil L. Routt, each of whom owns one share in each of said corporations, the stockholders of the two corporations, at the time of the filing of the petition, were different in each of said corporations.

(b) That ever since the incorporation of appellant, one-third of its capital stock was owned and held by M. D. Bishop (whose affidavit is to be found in the transcript, commencing on page 26), and that while the other two-thirds of the capital stock of the appellant were owned by the Routt Lumber Company up to about the 1st of March, 1931, that, nevertheless, at the time of the filing of the petition and for approximately four months prior thereto, the said two-thirds holding in appellant corporation was owned by W. E. Opie (whose affidavit is to be found in the transcript, commencing on page 31) and the Builders Finance Company.

(c) That M. C. Routt was not the owner of the majority of the stock of the Builders Finance Company, as contended on "information and belief" by Mr. Doyle in his affidavit in support of the petition, but that for a period of approximately two years preceding the filing of the petition M. C. Routt had not owned more than one share of stock in the said Builders Finance Company.

(d) The affidavits of A. E. Callahan, H. W. Hills and Betty Pohl, who had been employed at different times by either the Routt Lumber Company or Standard Planing Mill, and who had kept the records and conducted the affairs of these corporations and knew positively of their own knowledge and so state in their respective affidavits, that the two companies had kept their affairs separate and distinct, each with its own inventories, books of account, stock in trade, bank accounts, stockholders, officers, etc.

(e) The affidavits of Leonard W. Routt as secretary of appellant corporation and particularly his affidavit commencing on page 46 of the transcript, show conclusively that he was testifying as to facts which, as an officer of appellant corporation, were necessarily within his own knowledge, and give a complete answer to the unfounded and conjectural allegations in the petition, and the affidavits in support thereof based on hearsay.

(f) The only truthful allegation disclosed by the record is that these two corporations had the same office and place of business, but even as to this circumstance we find from the affidavit of Leonard W. Routt that the Standard Planing Mill in lieu of paying rent

to the Routt Lumber Company, paid the monthly power bills of the latter in the average monthly sum of $75.00. Surely, the fact that two separate corporations, engaged in allied industries, one in the raw product and the other in the manufactured product, share the same qaurters is not sufficient ground to declare them to be one and the same and to take the assets of the one and gratuitously hand them to the creditors of the other. Obviously, it is good business for such two corporations to share quarters and enjoy the business reciprocity which would naturally result from such an arrangement.

In contradistinction to the positive and definite affidavits in opposition to the petition made by persons who are testifying to facts absolutely within their own knowledge secured by them as a result of their connection with appellant corporation, we have, in support of the petition, merely the two affidavits of Mr. Krumbholz, the receiver for the Routt Lumber Company [pages 11 and 57 of the transcript], the affidavit of Mr. Doyle, one of the attorneys for the appellees [page 13 of the transcript], and the affidavit of Mr. Weed, employed as an auditor by the receiver [page 61 of the transcript]. These affidavits, we repeat, and urge most strongly, are based on hearsay and opinion and fraught with wild and unwarranted conjectures and conclusions, all of which appears plainly on the face of these affidavits.

Appellees have not only failed to maintain the burden of proof which was upon them, but the overwhelming preponderance of the evidence is a complete refutation of the allegations in the petition.

## POINT II.

### The Learned District Court Erred in Failing to Base the Order of June 29th, From Which This Appeal Is Taken, on Findings of Fact and Conclusions of Law.

We specifically direct the court's attention to the fact that the petition in this matter was not filed by the Receiver of the Routt Lumber Company in aid of his receivership and in order to secure possession of what he believed to be the assets of the Routt Lumber Company. This petition was filed by the appellees as creditors of the Routt Lumber Company [see petition in transcript commencing at page 35] and therefore, in our opinion, we are confronted not by a proceeding in bankruptcy but by a summary proceeding in equity, which requires under under Equity Rule 70½ (28 U. S. C. A., 1931 Cumulative Annual Pocket Part, page 3) specific findings of fact and separate conclusions of law based thereon. We submit that it is gross injustice to take the property and assets from the creditors and stockholders of appellant corporation in a summary proceeding of the character here resorted to, based upon a flimsy showing by persons who had no personal knowledge of the facts, and without any statement from the court as to the facts and law upon which the order was based. To take assets and property of one corporation and turn them over to another corporation, particularly upon the petition of creditors of the latter is, in view of the authorities hereinafter listed, an extremely summary and hasty procedure which, most assuredly, under the rule cited above, required a statement from the lower court of the facts and the law upon which he had based his order. All

that the creditors and stockholders of appellant corporation have in exchange for the assets and property of the company is the minute order of the court found on page 67 of the transcript.

It is true that appellant submitted itself to the jurisdiction of the court by appearing and filing affidavits in opposition to the petition, but we feel that since the record disclosed the allegations of the petition to be unfounded, and since appellant strenuously objected to the taking of property which it claimed as its own, the court was not authorized to proceed with a determination of the matter in this summary proceeding. *In re Iron Clad Mfg. Co.,* 194 Fed. 906. This case is in complete support of our position on this appeal.

## POINT III.

### (a) The Routt Lumber Company and Appellant Standard Planing Mill Were Not the Business Conduit and Alter Ego of One Another.

The facts in themselves as contained in the affidavits, clearly maintain our position. But the law too on this subject is not only significant, but exceptionally clear.

A leading case on this subject in this state is *Erkenbrecher v. Grant,* 187 Cal. 7, where the California Supreme Court said:

> "In order to cast aside the legal fiction of distinct corporate existence as distinguished from those who own its capital stock, it is not enough that it is so organized and controlled and its affairs so managed as to make it 'merely an instrumentality, conduit or adjunct' of its stockholders, but it must further ap-

> pear that they are the 'business conduits and *alter ego* of one another,' * * *. Divested of the essentials which we have enumerated, the mere circumstance that all the capital stock of the corporation is owned or controlled by one or more persons, does not, and should not, destroy its separate existence; were it otherwise, few private corporations could preserve their distinct identity, which would mean the complete destruction of the primary object of their organization. * * *. The contract company was a legal corporation, wholly distinct from the railroad company. The fact that the stockholders in each may have been the same persons does not operate to destroy the legal identity of their corporation. Neither does the fact that one corporation exercises a controlling influence over the other through the ownership of its stock or through the identity of the stockholders, operate to make either the agent of the other, or to merge the two corporations into one."

The doctrine of *alter ego* having been rejected in a situation as the case just cited, where we have an identity of stockholders and a controlling influence of one corporation over the other through stock ownership, will this court permit the doctrine of *alter ego* to be invoked in our situation where the ownership through stockholdings in each corporation is different and where each corporation had different officers, different management and separate and distinct business operations?

In *Allet v. Los Altos County Club,* 88 Cal. App. 741-746, the court said that in order to cast aside the legal fiction of district corporate existence it must appear that they are the business conduit and *alter ego* of one another

and that to recognize their separate entities would aid the consummation of a wrong. No showing of wrong-doing has been made in the case at bar. This point will, hereinafter, be more fully discussed.

See, also:

*Continental Securities v. Rawson,* 208 Cal. 228;

*Weaver v. Atlantian Construction Co.,* 84 Cal. App. 154;

*Kniese v. Fairfax,* 96 Cal. App. 427.

In *Wood Estate Co. v. Chanslor,* 209 Cal. 241, the court said:

> "Appellant's contention that the mining company was that 'in reality but the *alter ego* of the Wood Estate Company,' and Buel, does not merit a very serious consideration. *We feel that the evidence in this case falls far short of that necessary to permit this court to disregard the fiction of separate corporate existence.* It is quite true that the respondent, the Wood Estate Company was the owner of considerably over half the stock of the mining company, and it is also very likely that, as such majority stockholder, it controlled its policies. But these facts, standing alone can avail appellants but little. The law is well settled that, in order to cast aside the legal fiction of a distinct corporate existence it must appear that the corporation is the business conduit and *alter ego* of its stockholders, and that to recognize it as a separate unity would aid in the consummation of a wrong. In other words, not only must it appear that one man or two men own the stock and control the policies, but it must also be shown that there is such a unity of interest and ownership that the individuality of such corporation and such person or persons has ceased."

This court has followed the California rule, cited above, on the subject in controversy. We refer to two very recent cases of this court:

*In re John Koke Co.,* 38 Fed. (2d Series), 232;

*In re Finn v. George T. Mickle Lumber Co.,* 41 Fed. (2d Series), 676.

We refer the court particularly to the latter case of *Finn v. Mickle Lumber Co.* in which decision the court thoroughly discusses the question here in controversy and ably reviews the leading federal cases dealing with the subject, particularly the case of *in re Watertown Paper Co.,* 169 Fed. 252-255. We rely fully on the decision of this court in the case of *Finn v. Mickle Lumber Co., supra,* and the authorities therein cited. We specifically call the court's attention to the fact that in all of those cases the court refused to invoke the doctrine of *alter ego* notwithstanding the undisputed showing made in those cases that the stockholders in each of the corporations involved were the same, that the officers were the same and that one corporation owned stock in the other. How much stronger is our situation and our dissatisfaction with the order here appealed from when even those factors are not prevalent, since the corporations in the case at bar have different stockholders and officers as has already been stated.

**(b) The Lack of an Allegation and Proof of Fraud and Wrongdoing Is Absolutely Fatal to the Position of Appellees.**

The court will note that the petition does not allege any fraud or wrongdoing on the part of appellant and, as this court said in *Finn v. Mickle Lumber Co., supra,* "It must be clearly borne in mind that this is not a case in which a creditor is suing a corporation upon the ground that it has so held itself out in connection with another corporation as, upon principles of estoppel, to render it responsible for a particular debt of the latter." We have not the slightest evidence nor is there any allegation in the petition that any fraud was practised upon appellees by either the Routt Lumber Company or the Standard Planing Mill in any event, not by the Standard Planing Mill, since this appeal has reference only to that company, nor is there any allegation or proof that the appellees were induced by the Standard Planing Mill to extend credit to the Routt Lumber Company by the former holding itself out as having any connection with the latter. Nor is there any proof or allegation that the appellees did in fact extend credit to the Routt Lumber Company in reliance upon any representation made by the Standard Planing Mill that the two corporations were one and the same. There is not the slightest proof or allegation that the Standard Planing Mill ever knew or that it was interested in the fact that the appellees were extending credit to the Routt Lumber Company. Furthermore,

there is no allegation or proof of any fraud or wrongdoing or intention to defraud in the formation of either or both of the corporations in question.

Therefore, under the authorities cited above, in the absence of a showing of fraud or wrongdoing, even if the allegations in the petition were true, and they have not been substantiated, the order appealed from is erroneous.

## Conclusion.

We conscientiously believe that the lower court has committed a serious error because, without basis in fact or in law and in a summary proceeding of the character here involved, it has taken the assets and property of one corporation and gratuitously handed them to the creditors of another separate and distinct corporation.

We submit that the order appealed from should be reversed.

Respectfully submitted,

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